

IN RE JM LAND SDN BHD

HIGH COURT MALAYA, KUALA LUMPUR
HAMID SULTAN ABU BACKER J
[ORIGINATING PETITION NO: D-26NCC-119-2010]
24 DECEMBER 2010

COMPANY LAW: *Shares - Capital reduction - Petition for reduction of share capital - Whether petition could be heard without giving notice to creditors - Whether share capital can be reduced in secrecy - Whether court is duty bound to protect interest of creditors - Whether creditors will be prejudiced - Whether interest of creditors must be taken into account before court sanctions capital reduction - Companies Act 1965, s. 64*

This was the petitioner's application for directions ('encl. 3') in relation to the petition ('encl. 1') which was filed to obtain the court's approval for reduction of share capital pursuant to s. 64 of the Companies Act 1965 ('the Act'). In essence, the petitioner prayed that encl. 1 was to be heard without giving notice to the relevant parties inclusive of the creditors. The petitioner had intended to reduce the share capital where the credit arising from the said reduction would be used to set off the accumulated losses of the petitioner. For purpose of illustrating the financial effects of the proposed capital reduction, the petitioner had exhibited a pro-forma balance sheet which was based on the management accounts of the petitioner. Further, the petitioner asserted that the proposed reduction was not caught by s. 64 of the Act which provides safe guards to creditors. Hence, the issue that arose for consideration herein was whether the court could approve the petitioner's special resolution to reduce its share capital in secrecy.

Held (dismissing the petitioner's application):

- (1) In relation to reduction of capital, it is well established that the court is duty bound to protect the interest of creditors and other interested parties. This is to ensure that the share capital was not reduced to the prejudice of creditors. (*Re Exchange Banking Co.*; refd). Hence, by hearing and approving the said reduction without notice to the interested parties would not promote the legislative intent and well established principles in this area of law. (para 5)

- A (2) The pro-forma accounts *per se* did not deal with the assets called 'goodwill' which may be substantial as the petitioner was a profit generating concern. The effect of obtaining an order for reduction paved way for the return of capital to shareholders, not necessarily now, but maybe in the future. As
- B such, the interest of the creditors and other parties must be taken into account before the court sanctions capital reduction. (para 5)

C [The petitioner was directed to file the appropriate directions for advertisement in relation to the hearing of the petition.]

Case(s) referred to:

- Re Auscott Ltd (1998) Aust Fed Ct Lexis 402 (*refd*)
Re Barits Ho Chong Securities Co Ltd [2005] 1203 KHC 1 (*refd*)
Re Exchange Banking Co [1882] 21 Ch D 519 (*refd*)
- D Re MTD Infraperdana Bhd [2003] 7 CLJ 108 HC (*refd*)
Re Sonic Healthcare Ltd [2002] FCA 1235 (*refd*)

Legislation referred to:

Companies Act 1965, s. 64(1), (2)

E **Other source(s) referred to:**

A Ramaiya, *Guide to the Companies Act*, 12th edn, p 480
Walter Woon, *Company Law*, 2nd edn, p 623

For the petitioner - LK Mak; M/s Kadir, Andri & Partners

- F Reported by Kumitha Abdul Majid

JUDGMENT

G **Hamid Sultan Abu Backer J:**

- [1] This is my judgment in respect of the petitioner's application for directions (encl. 3) relating to the petition encl. 1 which has been filed to obtain the approval of court for the reduction of share capital pursuant to s. 64 of the Companies Act 1965 (CA 1965).
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In essence, the petitioner wants the petition to be heard without giving notice to the relevant parties inclusive of the creditors. The prayer in encl. 3 *inter alia* reads as follows:

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- (1) that the petition be heard forthwith; A
- (2) that the advertising of the notice of the presentation of the petition and the date of the hearing of the said petition be dispensed with; ...

The important question of public interest here is whether the court can approve the special resolution of the company to reduce the share capital in secrecy. The learned counsel for the petitioner says the court can. However, there is hardly any apex guidance in this area of jurisprudence though there are some remote cases from other jurisdiction which may not be applicable to the facts of this case. B C

Brief Facts

[2] In the instant case, the petitioner intends to reduce the share capital where the credit arising from the reduction will be used to set off the accumulated losses of the petitioner. The petitioner says: (i) that the reduction does not involve diminution of liability of shareholders to pay up on unpaid shares or the payment of any paid up capital; (ii) the capital reduction does not have any effect on the liabilities or the level of assets of the petitioner; (iii) no payment to shareholders or a diminution in the shareholders' liability to pay up on unpaid share capital. D E

[3] For purpose of illustrating the financial effects of the proposed capital reduction, the petitioner have exhibited a pro-forma balance sheet which is based on the management accounts of the petitioner. And says that this is the usual practice as may be seen from the following cases namely: (i) *Re Auscott Ltd* [1998] Aust Fed Ct Lexis 402; (ii) *Re MTD Infraperdana Bhd* [2003] 7 CLJ 108; (iii) *Re Sonic Healthcare Ltd* [2002] FCA 1235; (iv) *Re Barits Ho Chong Securities Co Ltd* [2005] 1203 KHC 1. F G

Petitioner's Argument

[4] To appreciate the petitioner's argument, ss. 64(1) and 64(2) CA 1965 need to be considered. This section says: H

- (1) Subject to confirmation by the Court a company may, if so authorized by its articles, by special resolution reduce its share capital in any way and in particular, without limiting the generality of the foregoing, may do all or any of the following: I

- A** (a) extinguish or reduce the liability on any of its shares in respect of share capital not paid-up;
- (b) cancel any paid-up share capital which is lost or unrepresented by available assets; or
- B** (c) pay off any paid-up share capital which is in excess of the needs of the company,
- and may so far as necessary alter its memorandum by reducing the amount of its share capital and of its shares accordingly.
- C** (2) Where the proposed reduction of share capital involves either diminution of liability in respect of unpaid share capital or the payment to any shareholder of any paid-up share capital, and in any other case if the Court so directs:
- D** (a) every creditor of the company who at the date fixed by the Court is entitled to any debt or claim which, if that date were the commencement of the winding up of the company, would be admissible in proof against the company shall be entitled to object to the reduction;
- E** (b) the Court, unless satisfied on affidavit that there are no such creditors, shall settle a list of creditors so entitled to object and for that purpose shall ascertain as far as possible without requiring an application from any creditor the names of those creditors and the nature and amount of their debts or claims, and may publish notices fixing a final day on or before which creditors not entered on the list may claim to be so entered; and
- F** (c) where a creditor entered on the list whose debt or claim is not discharged or has not determined does not consent to the reduction, the Court may dispense with the consent of that creditor on the company securing payment of his debt or claim by appropriating as the Court directs:
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- H** (i) if the company admits the full amount of the debt or claim or though not admitting it is willing to provide for it, the full amount of the debt or claim; or
- (ii) if the company does not admit and is not willing to provide for the full amount of the debt or claim or if the amount is contingent or not ascertained, an amount fixed by the Court after the like inquiry and adjudication as if the company were being wound up by the Court.
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The learned counsel for the petitioner says, the proposed capital reduction does not involve any diminution of liability in respect of unpaid share capital; nor any payment to any shareholder of any paid up capital for the creditors to object and in consequence if I understand the petitioner correctly it is not caught by s. 64, which provides safe guards to the creditors. And asserts that s. 64(2) CA 1965 is not applicable to the proposed capital reduction. And submits as follows:

24. The accumulated losses of the petitioner resulted from exceptional losses, provisions for doubtful debts, diminution in value of investments and operational losses accumulated over the years, despite that the petitioner was making profit all these years;

25. It is submitted that the above mentioned losses are capital losses and are permanent and not likely to be recovered in the near future;

26. Given that only losses which are permanent in nature will be set off against the credit arising out of the Proposed Capital Reduction, we submit that undertaking for the protection of creditors is not required in the present case: see *Jobs DB Hong Kong Ltd*, HCMP 2130/2005 (Lexis Report);

27. By reason of the aforementioned matters, it is humbly submitted that there is no likelihood that any person will be prejudiced by the Proposed Capital Reduction of the Petitioner;

28. The petitioner is still in operation and will continue to generate income to meet the needs of its business and the liabilities incurred. Existing creditors will still be paid in the ordinary course of business;

29. The accumulated losses of the Petitioner is not a constant figure and may change from month to month. In the unlikely event that the accumulated losses may be less than the credit arising upon reduction at the point in time when the credit is available to be utilized to eliminate accumulated losses, the Court may suitably make an order that the excess credit to be set aside in a reserve which shall not be distributable without a further order from the Court, subject to the Petitioner having the liberty to apply the reserve towards any purposes for which is for the benefit of the Petitioner.

A [5] I have read the application, and affidavits. After having giving much consideration to the submission of the learned counsel for the petitioner, I take the view that the applicant's prayer must be dismissed with appropriate directions. My reasons *inter alia* are as follows:

B (i) In the realm of jurisprudence relating to reduction of capital it is well established that court is duty bound to protect the interest of creditors and other interested parties to ensure that the share capital is not reduced to the prejudice of creditors.
C The reasons are obvious. In *Re Exchange Banking Co.* [1882] 21 Ch D 519 Jessel MR had this to say:

D The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor, therefore, I may say, gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders ...

E Learned author A. Ramaiya in the book titled "*Guide to the Companies Act*" 12th edn at p. 480 says that in exercising its power the court will have due regard to the interests of creditors, who may consent or object to the reduction. In the
F instant case, hearing and approving the reduction without notice to the interested parties will not promote legislative intent and well established principles in this area of law.

(ii) Learned author Walter Woon, "*Company Law*" 2nd edn does not prescribe for the petition to be heard *ex parte*, for any
G reasons. At p. 623 it is stated:

H The court is not primarily concerned with the business aspects of the capital reduction. When the court is asked to confirm a reduction it has a twofold function: first, to consider whether the creditors – present or future – would be prejudiced; secondly, to ensure that the reduction is fair among the member *inter se*. the court should also consider the public interest. It is not the court's function to consider whether the reduction is wise or desirable from a business point of view.

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Before confirming a reduction of capital, the court must be satisfied that with respect to every creditor who is entitled to object either his consent to the reduction has been obtained or his claim has been discharged or secured.

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- (iii) The authorities relied on by the petitioner does not subscribe to the facts of our case. More so, when the petitioner is relying on the proviso to s. 64(2) which deals with the court's discretion. In addition in this case unlike the facts of other cases cited the petitioner is operating profitably and is also expected to do so in the future. And the pro-forma accounts *per se* do not deal with the assets called "goodwill" which may be substantial as the petitioner is a profit generating concern. The effect of obtaining an order for reduction paves way for the return of capital to shareholders, not necessarily now, but may be in the future. It must be noted that there are well established principles to say that capital is not loss until it is permanently lost. In consequence the interest of the creditors and other parties must be taken into account before the court sanctions capital reduction.

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[6] For reasons stated above I dismiss the prayers in encl. 3, and give the following directions:

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- (i) The petitioner to file appropriate directions for advertisement of the hearing of the petition as per the current practice, within one week;
- (ii) In the event the petitioner intends to withdraw the petition with liberty to file afresh, the petitioner to bring to the attention of the court this judgment;
- (iii) The petition to be fixed for case management on 3 January 2011.

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I hereby order so.

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